

PANHANDLE OIL & GAS INC  
Form 10-Q  
February 06, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the period ended December 31, 2016

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-31759

PANHANDLE OIL AND GAS INC.

(Exact name of registrant as specified in its charter)

OKLAHOMA 73-1055775  
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)  
Grand Centre Suite 300, 5400 N Grand Blvd., Oklahoma City, Oklahoma 73112

(Address of principal executive offices)

Registrant's telephone number including area code (405) 948-1560

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer    Accelerated filer    Non-accelerated filer    Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes    No

Outstanding shares of Class A Common stock (voting) at February 6, 2017: 16,640,048

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The following defined terms are used in this report:

“Bbl” barrel.

“Board” board of directors.

“BTU” British Thermal Units.

“Company” Panhandle Oil and Gas Inc.

“completion” the process of treating a drilled well followed by the installation of permanent equipment for the production of crude oil and/or natural gas.

“DD&A” depreciation, depletion and amortization.

“dry hole” exploratory or development well that does not produce crude oil and/or natural gas in economic quantities.

“EBITDA” earnings before interest, taxes, depreciation and amortization.

“ESOP” the Panhandle Oil and Gas Inc. Employee Stock Ownership and 401(k) Plan, a tax qualified, defined contribution plan.

“exploratory well” a well drilled to find a new field or to find a new reservoir in a field previously found to be productive of crude oil or natural gas in another reservoir.

“FASB” the Financial Accounting Standards Board.

“field” an area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same individual geological structural feature or stratigraphic condition. The field name refers to the surface area, although it may refer to both the surface and the underground productive formations.

“G&A” general and administrative costs.

“gross acres” the total acres in which an interest is owned.

“held by production” or “HBP” an oil and gas lease continued into effect into its secondary term for so long as a producing oil and/or gas well is located on any portion of the leased premises or lands pooled therewith.

“horizontal drilling” a drilling technique used in certain formations where a well is drilled vertically to a certain depth and then drilled horizontally within a specified interval.

“IDC” intangible drilling costs.

“Independent Consulting Petroleum Engineer(s)” or “Independent Consulting Petroleum Engineering Firm” DeGolyer and MacNaughton of Dallas, Texas.

“LOE” lease operating expense.

“Mcf” thousand cubic feet.

“Mcf” natural gas stated on an Mcf basis and crude oil and natural gas liquids converted to a thousand cubic feet of natural gas equivalent by using the ratio of one Bbl of crude oil or natural gas liquids to six Mcf of natural gas.

“Mmbtu” million BTU.

“minerals”, “mineral acres” or “mineral interests” fee mineral acreage owned in perpetuity by the Company.

“net acres” the sum of the fractional interests owned in gross acres.

“NGL” natural gas liquids.

“NYMEX” New York Mercantile Exchange.

“Panhandle” Panhandle Oil and Gas Inc.

“play” term applied to identified areas with potential oil and/or natural gas reserves.

“proved reserves” the quantities of crude oil and natural gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates renewal is reasonably certain.

“royalty interest” well interests in which the Company does not pay a share of the costs to drill, complete and operate a well, but receives a much smaller proportionate share (as compared to a working interest) of production.

“SEC” the United States Securities and Exchange Commission.

“undeveloped acreage” lease acreage on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of crude oil and/or natural gas.

“working interest” well interests in which the Company pays a share of the costs to drill, complete and operate a well and receives a proportionate share of production.

“WTI” West Texas Intermediate.

#### Fiscal year references

All references to years in this report, unless otherwise noted, refer to the Company’s fiscal year end of September 30. For example, references to 2017 mean the fiscal year ended September 30, 2017.

#### Fiscal quarter references

All references to quarters in this report, unless otherwise noted, refer to the Company’s fiscal quarter based on a fiscal year end of September 30. For example, references to first quarter mean the quarter of October 1 through December 31.

#### References to oil and natural gas properties

References to oil and natural gas properties inherently include natural gas liquids associated with such properties.



## PART 1. FINANCIAL INFORMATION

## PANHANDLE OIL AND GAS INC.

## CONDENSED BALANCE SHEETS

	December 31, 2016 (unaudited)	September 30, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$484,989	\$471,213
Oil, NGL and natural gas sales receivables (net of allowance for uncollectable accounts)	5,526,787	5,287,229
Refundable income taxes	98,040	83,874
Other	273,397	419,037
Total current assets	6,383,213	6,261,353
Properties and equipment at cost, based on successful efforts accounting:		
Producing oil and natural gas properties	437,851,114	434,469,093
Non-producing oil and natural gas properties	7,538,806	7,574,649
Other	1,068,778	1,069,658
	446,458,698	443,113,400
Less accumulated depreciation, depletion and amortization	(256,491,564)	(251,707,749)
Net properties and equipment	189,967,134	191,405,651
Investments	172,352	157,322
Total assets	\$196,522,699	\$197,824,326
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$3,457,200	\$2,351,623
Derivative contracts, net	2,933,947	403,612
Accrued liabilities and other	1,968,967	1,718,558
Total current liabilities	8,360,114	4,473,793
Long-term debt	44,100,000	44,500,000
Deferred income taxes, net	29,569,007	30,676,007
Asset retirement obligations	2,990,823	2,958,048
Derivative contracts, net	10,587	24,659
Stockholders' equity:		
Class A voting common stock, \$.0166 par value; 24,000,000 shares authorized,		
16,863,004 issued at December 31, 2016, and September 30, 2016	280,938	280,938
Capital in excess of par value	2,476,066	3,191,056

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Deferred directors' compensation	3,509,031	3,403,213
Retained earnings	108,903,533	112,482,284
	115,169,568	119,357,491
Less treasury stock, at cost; 223,661 shares at December 31, 2016, and 262,708 shares		
at September 30, 2016	(3,677,400 )	(4,165,672 )
Total stockholders' equity	111,492,168	115,191,819
Total liabilities and stockholders' equity	\$ 196,522,699	\$ 197,824,326

(See accompanying notes)

(1)

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## PANHANDLE OIL AND GAS INC.

## CONDENSED STATEMENTS OF OPERATIONS

	Three Months Ended December 31,	
	2016	2015
Revenues:	(unaudited)	
Oil, NGL and natural gas sales	\$ 8,899,218	\$ 9,055,288
Lease bonuses and rentals	837,958	2,425,504
Gains (losses) on derivative contracts	(2,700,533 )	(34,936 )
Income (loss) from partnerships	15,030	16,269
	7,051,673	11,462,125
Costs and expenses:		
Lease operating expenses	3,049,415	3,566,536
Production taxes	367,845	321,841
Exploration costs	(2,243 )	27,790
Depreciation, depletion and amortization	4,834,263	6,957,652
Provision for impairment	-	3,733,273
Loss (gain) on asset sales and other	12,934	(269,706 )
Interest expense	292,369	360,562
General and administrative	1,842,482	1,912,079
Bad debt expense (recovery)	-	19,216
	10,397,065	16,629,243
Income (loss) before provision (benefit) for income taxes	(3,345,392 )	(5,167,118 )
Provision (benefit) for income taxes	(1,107,000 )	(2,368,000 )
Net income (loss)	\$ (2,238,392 )	\$ (2,799,118 )
Basic and diluted earnings (loss) per common share (Note 3)	\$ (0.13 )	\$ (0.17 )
Basic and diluted weighted average shares outstanding:		
Common shares	16,604,149	16,563,942
Unissued, directors' deferred compensation shares	274,035	255,060
	16,878,184	16,819,002
Dividends declared per share of common stock and paid in period	\$ 0.04	\$ 0.04
Dividends declared per share of common stock and to be paid in quarter ended March 31	\$ 0.04	\$ 0.04

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## STATEMENTS OF STOCKHOLDERS' EQUITY

Three Months Ended December 31, 2016

	Class A voting Common Stock Shares	Amount	Capital in Excess of Par Value	Deferred Directors' Compensation	Retained Earnings	Treasury Shares	Treasury Stock	Total
Balances at September 30, 2016	16,863,004	\$280,938	\$3,191,056	\$3,403,213	\$112,482,284	(262,708)	\$(4,165,672)	\$115,191,819
Purchase of treasury stock	-	-	-	-	-	(17,119 )	(407,677 )	(407,677 )
Restricted stock awards	-	-	180,412	-	-	-	-	180,412
Net income (loss)	-	-	-	-	(2,238,392 )	-	-	(2,238,392 )
Dividends (\$ .08 per share)	-	-	-	-	(1,340,359 )	-	-	(1,340,359 )
Distribution of restricted stock to  officers and directors	-	-	(895,402 )	-	-	56,166	895,949	547
Increase in deferred directors'  compensation charged to  expense	-	-	-	105,818	-	-	-	105,818
Balances at December 31, 2016 (unaudited)	16,863,004	\$280,938	\$2,476,066	\$3,509,031	\$108,903,533	(223,661)	\$(3,677,400)	\$111,492,168

Three Months Ended December 31, 2015

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	Class A voting Common Stock Shares	Amount	Capital in Excess of Par Value	Deferred Directors' Compensation	Retained Earnings	Treasury Shares	Treasury Stock	Total
Balances at September 30, 2015	16,863,004	\$280,938	\$2,993,119	\$3,084,289	\$125,446,473	(302,623)	\$(4,800,144)	\$127,004,675
Purchase of treasury stock	-	-	-	-	-	(7,477 )	(117,165 )	(117,165 )
Restricted stock awards	-	-	371,407	-	-	-	-	371,407
Net income (loss)	-	-	-	-	(2,799,118 )	-	-	(2,799,118 )
Dividends (\$0.08 per share)	-	-	-	-	(1,337,982 )	-	-	(1,337,982 )
Distribution of restricted stock to  officers and directors	-	-	(449,307 )	-	-	25,507	404,541	(44,766 )
Increase in deferred directors'  compensation charged to  expense	-	-	-	85,930	-	-	-	85,930
Balances at December 31, 2015 (unaudited)	16,863,004	\$280,938	\$2,915,219	\$3,170,219	\$121,309,373	(284,593)	\$(4,512,768)	\$123,162,981

(See accompanying notes)

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## PANHANDLE OIL AND GAS INC.

## CONDENSED STATEMENTS OF CASH FLOWS

	Three months ended December 31,	
	2016	2015
	(unaudited)	
Operating Activities		
Net income (loss)	\$(2,238,392)	\$(2,799,118 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion and amortization	4,834,263	6,957,652
Impairment	-	3,733,273
Provision for deferred income taxes	(1,107,000)	(3,747,000 )
Exploration costs	(2,243 )	27,790
Gain from leasing fee mineral acreage	(837,732 )	(2,425,131 )
Proceeds from leasing fee mineral acreage	847,578	2,693,812
Net (gain) loss on sales of assets	-	(271,080 )
Amortization of partnerships	2,541	19,984
Directors' deferred compensation expense	105,818	85,930
Restricted stock awards	180,412	371,407
Bad debt expense (recovery)	-	19,216
Cash provided (used) by changes in assets and liabilities:		
Oil, NGL and natural gas sales receivables	(239,558 )	2,335,449
Fair value of derivative contracts	2,516,263	3,574,650
Refundable production taxes	-	1,162
Other current assets	145,640	(659,324 )
Accounts payable	(90,474 )	(484,882 )
Income taxes receivable	(14,166 )	345,897
Income taxes payable	-	1,073,551
Accrued liabilities	(419,299 )	(509,208 )
Total adjustments	5,922,043	13,143,148
Net cash provided by operating activities	3,683,651	10,344,030
Investing Activities		
Capital expenditures, including dry hole costs	(2,174,523)	(1,286,114 )
Investments in partnerships	(17,571 )	44,842
Proceeds from sales of assets	-	627,547
Net cash provided (used) by investing activities	(2,192,094)	(613,725 )
Financing Activities		
Borrowings under debt agreement	4,436,304	2,958,515
Payments of loan principal	(4,836,304)	(10,958,515)
Purchases of treasury stock	(407,677 )	(117,165 )
Payments of dividends	(670,104 )	(668,364 )
Excess tax benefit on stock-based compensation	-	(45,000 )
Net cash provided (used) by financing activities	(1,477,781)	(8,830,529 )

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Increase (decrease) in cash and cash equivalents	13,776	899,776
Cash and cash equivalents at beginning of period	471,213	603,915
Cash and cash equivalents at end of period	\$484,989	\$1,503,691
<b>Supplemental Schedule of Noncash Investing and Financing Activities:</b>		
Dividends declared and unpaid	\$670,255	\$669,618
Additions to asset retirement obligations	\$594	\$4,524
Gross additions to properties and equipment	\$3,370,574	\$3,455,245
Net (increase) decrease in accounts payable for properties and equipment additions	(1,196,051)	(2,169,131 )
Capital expenditures and acquisitions, including dry hole costs	\$2,174,523	\$1,286,114

(See accompanying notes)

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PANHANDLE OIL AND GAS INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1: Basis of Presentation and Accounting Principles

Basis of Presentation

The accompanying unaudited condensed financial statements of Panhandle Oil and Gas Inc. have been prepared in accordance with the instructions to Form 10-Q as prescribed by the SEC. Management of the Company believes that all adjustments necessary for a fair presentation of the financial position and results of operations and cash flows for the periods have been included. All such adjustments are of a normal recurring nature. The results are not necessarily indicative of those to be expected for the full year. The Company's fiscal year runs from October 1 through September 30.

Certain amounts and disclosures have been condensed or omitted from these financial statements pursuant to the rules and regulations of the SEC. Therefore, these condensed financial statements should be read in conjunction with the financial statements and related notes thereto included in the Company's 2016 Annual Report on Form 10-K.

Adoption of New Accounting Pronouncements

In April 2015, the FASB issued Accounting Standards Update ("ASU") 2015-03, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The update requires that debt issuance costs related to a recognized debt liability, such as senior notes, term loans and note payables, be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. Under previous guidance, debt issuance costs were required to be presented in the balance sheet as an asset. The recognition and measurement guidance for debt issuance costs is not affected by the update. For public entities, the guidance is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years.

In August 2015, the FASB issued ASU 2015-15, Interest—Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, which allows for line-of-credit arrangements to be handled consistently with the presentation of debt issuance costs prior to ASU 2015-03 issued in April 2015. For public entities, the guidance is effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years.

The Company adopted ASU 2015-03 and ASU 2015-15 as of December 31, 2016. The Company elected to continue to show debt issuance costs associated with its credit facility (Company's only debt) as assets versus a direct reduction of the debt liability. Therefore, the adoption had no impact on the Company's current and previously reported balance sheets, shareholders' equity, results of operations, or cash flows. In accordance with ASU 2015-15, unamortized debt issuance costs associated with the Company's credit facility, which amounted to \$232,928 and \$263,584 as of December 31, 2016, and September 30, 2016, respectively, remain reflected in "Other property and equipment" on the balance sheets.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes. The update requires that deferred income tax assets and liabilities be classified as noncurrent in the balance sheet. For public entities, the guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within



those fiscal years.

The Company early adopted ASU 2015-17 as of December 31, 2016, on a retrospective basis to all prior balance sheet periods presented. As a result of the adoption, the Company reclassified \$201,900 and \$310,900 as of December 31, 2016, and September 30, 2016, respectively, from "Deferred income taxes" in current assets to "Deferred income tax, net" in long term liabilities on the balance sheets. Adoption of ASU 2015-17 had no impact on the Company's current and previously reported shareholders' equity, results of operations or cash flows. The affected prior period deferred income tax account balances presented throughout this report on Form 10-Q have been adjusted to reflect the retroactive adoption of ASU 2015-17.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments, which addresses certain issues where diversity in practice was identified and may change how an entity classifies certain cash receipts and cash payments on its statement of cash flows. The new guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. This guidance will generally be applied retrospectively and is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted. All of the amendments in ASU 2016-15 are required to be adopted at the same time.

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The Company early adopted ASU 2016-15 as of December 31, 2016. As a result of the adoption, the Company reclassified "Proceeds from leasing fee mineral acreage", which totaled \$847,578 and \$2,693,812 as of December 31, 2016, and December 31, 2015, respectively, from Investing Activities to Operating Activities on the Condensed Statements of Cash Flows as these transactions are made in our normal course of business and represent operating activities based on the application of the predominance principle. As another result of this adoption, we are also electing to classify our distributions received from equity method investments using the Cumulative Earnings Approach. Distributions received are considered returns on investment and classified as cash inflows from operating activities, unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess should be considered a return of investment and classified as cash inflows from investing activities. This election did not have any impact on our cash flow statements as the Company was already applying this approach. Adoption of ASU 2016-15 had no impact on the Company's current and previously reported shareholders' equity, results of operations or balance sheets. The affected prior period balances in the Condensed Statements of Cash Flows presented throughout this report on Form 10-Q have been adjusted to reflect the retroactive adoption of ASU 2016-15.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The new guidance is intended to improve the accounting for employee share-based payments and affect all organizations that issue share-based payment awards to their employees. The guidance changes how companies account for certain aspects of share-based payment awards, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, and will be adopted either prospectively, retrospectively or using a modified retrospective transition approach depending on the topic covered in the standard. Early adoption is permitted for any organization in any interim or annual period. On a prospective basis companies will no longer record excess tax benefits and deficiencies in additional paid-in capital. Instead, excess tax benefits and deficiencies will be recognized as income tax expense or benefit in the income statement. This is expected to result in increased volatility in income tax expense/benefit and corresponding variations in the relationship between income tax expense/benefit and pre-tax income/loss from period to period. Also, companies will have to present excess tax benefits and deficiencies as operating activities on the statement of cash flows (prospectively or retrospectively). The new guidance will also require an employer to classify as a financing activity in its statement of cash flows the cash paid to a tax authority when shares are withheld to satisfy the employer's statutory income tax withholding obligation.

The Company early adopted ASU 2016-09 as of October 1, 2016. As a result of the adoption, the Company recorded \$228,000 of excess tax benefits from stock-based compensation in the "Provision (benefit) for income taxes" on the Condensed Statements of Operations in the current period versus "Capital in excess of par" on the Condensed Balance Sheets as was previously required. This part of the guidance is to be applied prospectively, so the prior period balances have not been reclassified. The Company also presented excess tax benefits from stock-based compensation in the "Operating Activities" section of the Condensed Statements of Cash Flows in the current period versus the "Financing Activities" section of the Condensed Statements of Cash Flows as was previously presented. The Company has elected to apply this part of the guidance prospectively, so the prior period balances have not been reclassified. The guidance also requires that companies present employees taxes paid upon vesting as financing activities on the statement of cash flows. This requirement had no impact on the Company, as this has been the practice historically. The Company is also electing to account for forfeitures of awards as they occur, instead of estimating a forfeiture amount. A cumulative-effect adjustment to retained earnings was not necessary for this transition as there were no material forfeitures estimated or incurred in the past.

New Accounting Pronouncements yet to be Adopted

In February 2016, the FASB issued its new lease accounting guidance in ASU 2016-02, Leases (Topic 842). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: 1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and 2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The new lease guidance simplified the accounting for sale and leaseback transactions primarily because lessees must recognize lease assets and lease liabilities. Lessees will no longer be provided with a source of off-balance sheet financing. For public entities, the guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted for all public business entities upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. We are assessing the potential impact that this update will have on our financial statements.

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In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The new guidance is intended to improve the recognition and measurement of financial instruments. The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are assessing the potential impact that this update will have on our financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which will supersede nearly all existing revenue recognition guidance under GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. We are evaluating our existing revenue recognition policies to determine whether any contracts in the scope of the guidance will be affected by the new requirements. The standard is effective for us on October 1, 2018. The standard allows for either "full retrospective" adoption, meaning the standard is applied to all of the periods presented, or "modified retrospective" adoption, meaning the standard is applied only to the most current period presented in the financial statements. We are currently evaluating the potential impact that this update will have on our financial statements and the transition method that will be elected.

Other accounting standards that have been issued or proposed by the FASB, or other standards-setting bodies, that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption.

#### NOTE 2: Income Taxes

The Company's provision for income taxes differs from the statutory rate primarily due to estimated federal and state benefits generated from estimated excess federal and Oklahoma percentage depletion, which are permanent tax benefits. Excess percentage depletion, both federal and Oklahoma, can only be taken in the amount that it exceeds cost depletion which is calculated on a unit-of-production basis.

Both excess federal percentage depletion, which is limited to certain production volumes and by certain income levels, and excess Oklahoma percentage depletion, which has no limitation on production volume, reduce estimated taxable income or add to estimated taxable loss projected for any year. The federal and Oklahoma excess percentage depletion estimates will be updated throughout the year until finalized with detailed well-by-well calculations at fiscal year-end. Federal and Oklahoma excess percentage depletion, when a provision for income taxes is expected for the year, decreases the effective tax rate, while the effect is to increase the effective tax rate when a benefit for income taxes is expected for the year. The benefits of federal and Oklahoma excess percentage depletion are not directly related to the amount of pre-tax income recorded in a period. Accordingly, in periods where a recorded pre-tax income or loss is relatively small, the proportional effect of these items on the effective tax rate may be significant. The effective tax rate for the quarter ended December 31, 2016, was 33% as compared to 46% for the quarter ended December 31, 2015.

#### NOTE 3: Basic and Diluted Earnings (Loss) per Share

Basic and diluted earnings (loss) per share is calculated using net income (loss) divided by the weighted average number of voting common shares outstanding, including unissued, vested directors' deferred compensation shares during the period.

#### NOTE 4: Long-term Debt

The Company has a \$200,000,000 credit facility with a group of banks headed by Bank of Oklahoma (BOK) with a current borrowing base of \$80,000,000 and a maturity date of November 30, 2018. The credit facility is subject to a semi-annual borrowing base determination, wherein BOK applies their commodity pricing forecast to the Company's reserve forecast and determines a borrowing base. The facility is secured by certain of the Company's properties with a net book value of \$162,622,006 at December 31, 2016. The interest rate is based on BOK prime plus from 0.375% to 1.125%, or 30 day LIBOR plus from 1.875% to 2.625%. The election of BOK prime or LIBOR is at the Company's discretion. The interest rate spread from BOK prime or LIBOR will be charged based on the ratio of the loan balance to the borrowing base. The interest rate spread from LIBOR or the prime rate increases as a larger percent of the borrowing base is advanced. At December 31, 2016, the effective interest rate was 2.81%.

The Company's debt is recorded at the carrying amount on its balance sheet. The carrying amount of the Company's revolving credit facility approximates fair value because the interest rates are reflective of market rates.

Determinations of the borrowing base are made semi-annually (June and December) or whenever the banks, in their discretion, believe that there has been a material change in the value of the oil and natural gas properties. In December 2016, the borrowing base was redetermined by the banks and left unchanged at \$80,000,000. The loan agreement contains customary covenants which, among other things, require periodic financial and reserve reporting and place certain limits on the Company's incurrence of

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indebtedness, liens, payment of dividends and acquisitions of treasury stock. In addition, the Company is required to maintain certain financial ratios, a current ratio (as defined – current assets includes availability under outstanding credit facility) of no less than 1.0 to 1.0 and a funded debt to EBITDA (trailing twelve months as defined) of no more than 4.0 to 1.0. At December 31, 2016, the Company was in compliance with the covenants of the loan agreement and has \$35,900,000 of availability under its outstanding credit facility.

**NOTE 5: Deferred Compensation Plan for Non-Employee Directors**

Annually, non-employee directors may elect to be included in the Deferred Compensation Plan for Non-Employee Directors. The Deferred Compensation Plan for Non-Employee Directors provides that each outside director may individually elect to be credited with future unissued shares of Company common stock rather than cash for all or a portion of the annual retainers, Board meeting fees and committee meeting fees, and may elect to receive shares, when issued, over annual time periods up to ten years. These unissued shares are recorded to each director's deferred compensation account at the closing market price of the shares (i) on the dates of the Board and committee meetings, and (ii) on the payment dates of the annual retainers. Only upon a director's retirement, termination, death, or a change-in-control of the Company will the shares recorded for such director under the Deferred Compensation Plan for Non-Employee Directors be issued to the director. The promise to issue such shares in the future is an unsecured obligation of the Company.

**NOTE 6: Restricted Stock Plan**

In March 2010, shareholders approved the Panhandle Oil and Gas Inc. 2010 Restricted Stock Plan (2010 Stock Plan), which made available 200,000 shares of common stock to provide a long-term component to the Company's total compensation package for its officers and to further align the interest of its officers with those of its shareholders. In March 2014, shareholders approved an amendment to increase the number of shares of common stock reserved for issuance under the 2010 Stock Plan from 200,000 shares to 500,000 shares and to allow the grant of shares of restricted stock to our directors. The 2010 Stock Plan, as amended, is designed to provide as much flexibility as possible for future grants of restricted stock so that the Company can respond as necessary to provide competitive compensation in order to retain, attract and motivate directors and officers of the Company and to align their interests with those of the Company's shareholders.

Effective in May 2014, the board of directors adopted resolutions to allow management, at their discretion, to purchase the Company's common stock up to an amount equal to the aggregate number of shares of common stock awarded pursuant to the Company's Amended 2010 Restricted Stock Plan, contributed by the Company to its ESOP and credited to the accounts of directors pursuant to the Deferred Compensation Plan for Non-Employee Directors.

On December 9, 2016, the Company awarded 6,845 non-performance based shares and 20,531 performance based shares of the Company's common stock as restricted stock to certain officers. The restricted stock vests at the end of a three-year period and contains non-forfeitable rights to receive dividends and voting rights during the vesting period. The non-performance and performance based shares had a fair value on their award date of \$176,260 and \$292,884, respectively. The fair value for the performance and the non-performance based awards will be recognized as compensation expense ratably over the vesting period. The fair value of the performance based shares on their award date is calculated by simulating the Company's stock prices as compared to the Dow Jones Select Oil Exploration and Production Index (DJSOEP) prices utilizing a Monte Carlo model covering the performance period (December 9, 2016, through December 9, 2019).

On December 31, 2016, the Company awarded 7,430 non-performance based shares of the Company's common stock as restricted stock to its non-employee directors. The restricted stock vests quarterly over one year starting on March 31, 2017. The restricted stock contains non-forfeitable rights to receive dividends and voting rights during the vesting

period. These non-performance based shares had a fair value on their award date of \$174,975.

The following table summarizes the Company's pre-tax compensation expense for the three months ended December 31, 2016 and 2015, related to the Company's performance based and non-performance based restricted stock.

	Three Months Ended	
	December 31,	
	2016	2015
Performance based, restricted stock	\$79,216	\$269,510
Non-performance based, restricted stock	101,196	101,897
Total compensation expense	\$180,412	\$371,407

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A summary of the Company's unrecognized compensation cost for its unvested performance based and non-performance based restricted stock and the weighted-average periods over which the compensation cost is expected to be recognized are shown in the following table.

	As of December 31, 2016	
	Unrecognized Compensation	Weighted Average Period (in years)
Performance based, restricted stock	\$ 421,524	2.37
Non-performance based, restricted stock	454,090	1.87
Total	\$ 875,614	

Upon vesting, shares are expected to be issued out of shares held in treasury.

#### NOTE 7: Oil, NGL and Natural Gas Reserves

Management considers the estimation of the Company's crude oil, NGL and natural gas reserves to be the most significant of its judgments and estimates. Changes in crude oil, NGL and natural gas reserve estimates affect the Company's calculation of DD&A, provision for retirement of assets and assessment of the need for asset impairments. On an annual basis, with a semi-annual update, the Company's Independent Consulting Petroleum Engineer, with assistance from Company staff, prepares estimates of crude oil, NGL and natural gas reserves based on available geological and seismic data, reservoir pressure data, core analysis reports, well logs, analogous reservoir performance history, production data and other available sources of engineering, geological and geophysical information. Between periods in which reserves would normally be calculated, the Company updates the reserve calculations utilizing appropriate prices for the current period. The estimated oil, NGL and natural gas reserves were computed using the 12-month average price calculated as the unweighted arithmetic average of the first-day-of-the-month oil, NGL and natural gas price for each month within the 12-month period prior to the balance sheet date, held flat over the life of the properties. However, projected future crude oil, NGL and natural gas pricing assumptions are used by management to prepare estimates of crude oil, NGL and natural gas reserves and future net cash flows used in asset impairment assessments and in formulating management's overall operating decisions. Crude oil, NGL and natural gas prices are volatile and affected by worldwide production and consumption and are outside the control of management.

#### NOTE 8: Impairment

All long-lived assets, principally oil and natural gas properties, are monitored for potential impairment when circumstances indicate that the carrying value of the asset may be greater than its estimated future net cash flows. The evaluations involve significant judgment since the results are based on estimated future events, such as: inflation rates; future drilling and completion costs; future sales prices for oil, NGL and natural gas; future production costs; estimates of future oil, NGL and natural gas reserves to be recovered and the timing thereof; the economic and regulatory climates and other factors. The need to test a property for impairment may result from significant declines in sales prices or unfavorable adjustments to oil, NGL and natural gas reserves. Between periods in which reserves would normally be calculated, the Company updates the reserve calculations to reflect any material changes since the prior report was issued and then utilizes updated projected future price decks current with the period. For the three months ended December 31, 2016 and 2015, the assessment resulted in impairment provisions on producing properties of \$0 and \$3,733,273, respectively. A significant reduction in oil, NGL and natural gas prices or a decline in reserve volumes may lead to additional impairment in future periods that may be material to the Company.



NOTE 9: Capitalized Costs

As of December 31, 2016, and September 30, 2016, non-producing oil and natural gas properties include costs of \$0 and \$5,917, respectively, on exploratory wells which were drilling and/or testing.

NOTE 10: Derivatives

The Company has entered into commodity price derivative agreements including fixed swap contracts and costless collar contracts. These instruments are intended to reduce the Company's exposure to short-term fluctuations in the price of oil and natural gas. Fixed swap contracts set a fixed price and provide payments to the Company if the index price is below the fixed price, or require payments by the Company if the index price is above the fixed price. Collar contracts set a fixed floor price and a fixed ceiling price and provide payments to the Company if the index price falls below the floor or require payments by the Company if the index price rises above the ceiling. These contracts cover only a portion of the Company's natural gas and oil production and provide only partial price protection against declines in natural gas and oil prices. These derivative instruments may expose the Company to risk of

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financial loss and limit the benefit of future increases in prices. All of the Company's derivative contracts are with Bank of Oklahoma and are secured under its credit facility with Bank of Oklahoma. The derivative instruments have settled or will settle based on the prices below.

Derivative contracts in place as of December 31, 2016

Contract period	Production volume covered per month	Index	Contract price
Natural gas costless collars			
November 2016 - March 2017	50,000 Mmbtu	NYMEX Henry Hub	\$2.25 floor / \$3.65 ceiling
November 2016 - March 2017	80,000 Mmbtu	NYMEX Henry Hub	\$2.25 floor / \$3.95 ceiling
November 2016 - March 2017	50,000 Mmbtu	NYMEX Henry Hub	\$2.60 floor / \$3.25 ceiling
January - March 2017	30,000 Mmbtu	NYMEX Henry Hub	\$3.20 floor / \$4.00 ceiling
January - June 2017	50,000 Mmbtu	NYMEX Henry Hub	\$2.85 floor / \$3.35 ceiling
January - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$2.80 floor / \$3.47 ceiling
January - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$3.00 floor / \$3.35 ceiling
April - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$2.80 floor / \$3.35 ceiling
April - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$2.75 floor / \$3.35 ceiling
April - December 2017	30,000 Mmbtu	NYMEX Henry Hub	\$3.00 floor / \$3.65 ceiling
May - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$3.00 floor / \$3.60 ceiling
May - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$3.20 floor / \$3.65 ceiling
January - March 2018	100,000 Mmbtu	NYMEX Henry Hub	\$3.50 floor / \$3.95 ceiling
Natural gas fixed price swaps			
October 2016 - March 2017	25,000 Mmbtu	NYMEX Henry Hub	\$3.200
November 2016 - April 2017	80,000 Mmbtu	NYMEX Henry Hub	\$2.955
January - March 2017	50,000 Mmbtu	NYMEX Henry Hub	\$3.665
January - December 2017	25,000 Mmbtu	NYMEX Henry Hub	\$3.100
April - December 2017	50,000 Mmbtu	NYMEX Henry Hub	\$3.070
April - December 2017	50,000 Mmbtu		